

ST 03-12

Tax Type: Sales Tax

Issue: Gross Receipts

Unreported/Underreported Receipts (Fraud Application)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket No.	01-ST-0000
OF THE STATE OF ILLINOIS)	Reg. No.	0000-0000
v.)	NTL No.	00-0000000000000000
ABC SALOON, INC.,)	John E. White,	
Taxpayer.)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances:

Timothy Touhy, Touhy & Touhy, Ltd., appeared for ABC Saloon, Inc.; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after ABC Saloon, Inc. ("ABC" or "taxpayer") protested a Notice of Tax Liability ("NTL") the Illinois Department of Revenue ("Department") issued to it, after an audit of taxpayer's business. The NTL assessed retailers' occupation tax ("ROT"), penalties and interest as measured by the gross receipts ABC received from selling tangible personal property at retail during the months beginning January 1, 1998 through and including March 31, 2000.

Pursuant to a pre-hearing order, the parties agreed that the issues to be resolved at hearing were whether the Department correctly calculated ABC's taxable gross receipts, and whether the Department's assessment of a fraud penalty was proper. At hearing, taxpayer introduced into evidence certain documents and the testimony of John Doe, taxpayer's owner. I have considered the evidence adduced at hearing, and I am including

in this recommendation specific findings of fact and conclusions of law. I recommend that the NTL be finalized as issued.

Findings of Fact:

1. ABC operates a tavern in Anywhere, Illinois. Department Ex. 1, p. 1 (“Kind of business” description on the Department’s original correction of taxpayer’s returns).
2. The Department conducted an audit of ABC’s business regarding the months of January 1, 1998 through and including March 31, 2000. Department Ex. 1.
3. At the beginning of the audit, the Department’s auditor asked taxpayer to produce its cash register records, or “z-tapes,” and its bank records. Hearing Transcript (“Tr.”), p. 70 (testimony of John Doe (“Doe”), taxpayer’s owner).
4. Most of ABC’s z-tapes identify separately the amount of gross receipts rung up as having been received from bar sales, i.e., sales of beer or liquor for immediate consumption by patrons at the tavern, and the gross receipts rung up as having been received from sales of packaged goods. Taxpayer Ex. 1 (z-tapes for 1999); Tr. pp. 72-73, 75 (Doe).
5. As a result of the audit, the Department disregarded the amounts ABC reported as gross receipts on the monthly returns it filed during the audit period. *See* Department Ex. 2.
6. The Department also determined that ABC was liable for a fraud penalty. Department Exs. 1-2.
7. ABC offered its z-tapes for 1999 into evidence at hearing. Department Ex. 1.

8. The z-tapes provide the following information:

Day of Month	January-99			February-99			March-99		
	Bar	Package	Total	Bar	Package	Total	Bar	Package	Total
1				408.50	104.00	512.50	339.25	52.00	391.25
2				395.00	73.00	468.00	186.50	37.00	223.50
3							285.50	48.00	333.50
4				760.25	116.00	876.25	491.50	95.00	586.50
5	237.50	65.00	302.50	276.25	72.00	348.25	337.25	64.00	401.25
6	252.25	50.00	302.25	273.00	60.00	333.00	364.50	104.00	468.50
7	365.25	84.00	449.25						
8	285.25	84.00	369.25	357.25	44.00	401.25	362.75	68.00	430.75
9				368.25	65.00	433.25	523.50	73.00	596.50
10							305.50	48.00	353.50
11	165.00	16.00	181.00	329.50	96.00	425.50	425.25	78.00	503.25
12	336.50	72.00	408.50	279.00	60.00	339.00	432.50	130.00	562.50
13	229.00	52.00	281.00	275.75	32.00	307.75	469.00	72.00	541.00
14	204.75	12.00	216.75				204.25	8.00	212.25
15	265.75	84.00	349.75	184.00	16.00	200.00	292.50	40.00	332.50
16	342.00	0.00	342.00	269.50	82.00	351.50	327.00	56.00	383.00
17							1,535.75	202.00	1,737.75
18	190.00	12.00	202.00	238.75	24.00	262.75	478.75	44.00	522.75
19	280.25	63.00	343.25	352.50	82.00	434.50	419.00	88.00	507.00
20	224.00	12.00	236.00	452.25	116.00	568.25	388.50	64.00	452.50
21	335.75	72.00	407.75						
22	490.00	140.00	630.00	279.00	72.00	351.00	275.75	44.00	319.75
23	497.25	123.00	620.25	380.50	72.00	452.50	192.50	32.00	224.50
24				251.25	28.00	279.25	307.25	86.00	393.25
25	197.75	44.00	241.75	300.00	28.00	328.00	291.25	48.00	339.25
26	386.50	96.00	482.50	357.75	98.00	455.75	394.25	80.00	474.25
27	366.00	40.00	406.00	310.75	64.00	374.75			
28	340.75	78.00	418.75						
29	344.75	68.00	412.75				264.25	36.00	300.25
30							284.00	49.00	333.00
31	384.00	16.00	400.00				368.75	132.00	500.75
Total per z-tapes	6,720.25	1,283.00	8,003.25	7,099.00	1,404.00	8,503.00	10,546.75	1,878.00	12,424.75
Total per ST-1's			10,886.00			12,459.00			15,138.00
Total per TP Exs. 2 + 3			16,938.75			16,938.75			16,938.75

Day of Month	April-99			May-99			June-99		
	Bar	Package	Total	Bar	Package	Total	Bar	Package	Total
1	677.50	206.00	883.50	372.50	76.00	448.50	417.50	88.00	505.50
2	238.00	104.00	342.00				352.25	48.00	400.25
3	289.50	56.00	345.50	285.75	36.00	321.75	297.50	60.00	357.50
4				287.00	44.00	331.00	337.75	88.00	425.75
5	276.25	24.00	300.25	514.25	100.00	614.25	358.00	84.00	442.00
6	248.75	48.00	296.75	741.50	0.00	741.50			
7				341.75	64.00	405.75	297.75	48.00	345.75
8				314.75	64.00	378.75	228.00	36.00	264.00
9	355.75	64.00	419.75				610.50	172.00	782.50
10	372.25	44.00	416.25	346.25	44.00	390.25	255.75	52.00	307.75
11				452.25	76.00	528.25	399.50	72.00	471.50
12	328.00	24.00	352.00	433.75	64.00	497.75	367.75	79.00	446.75
13	618.25	70.00	688.25	672.75	124.00	796.75			
14	287.50	32.00	319.50	313.50	72.00	385.50	257.00	56.00	313.00
15	684.50	119.00	803.50	284.00	60.00	344.00	326.25	73.00	399.25
16	309.25	56.00	365.25				229.50	56.00	285.50
17	344.25	60.00	404.25	329.25	36.00	365.25	496.00	64.00	560.00
18				336.50	77.00	413.50	336.75	96.00	432.75
19	250.50	36.00	286.50				382.50	84.00	466.50
20	244.75	58.00	302.75	396.25	124.00	520.25			
21	296.25	44.00	340.25	361.25	104.00	465.25			301.00
22	520.50	98.00	618.50	356.50	88.00	444.50	422.50	84.00	506.50
23	391.75	96.00	487.75				410.25	148.00	558.25
24	397.50	107.00	504.50						
25				354.50	129.00	483.50	394.75	104.00	498.75
26				460.50	192.00	652.50	268.75	64.00	332.75
27	424.00	36.00	460.00	773.75	176.00	949.75			
28				136.25	112.00	248.25	271.75	48.00	319.75
29						374.00	298.50	94.00	392.50
30	430.00	0	430.00				250.25	76.00	326.25
Total per z-tapes	7,985.00	1,382.00	9,367.00			11,100.75			10,442.00
Total per ST-1's			14,373.00			13,480.00			13,373.00
Total per TP Exs. 2 + 3			16,938.75			16,938.75			16,938.75

Day of Month	July-99			August-99			September-99		
	Bar	Package	Total	Bar	Package	Total	Bar	Package	Total
1	336.25	88.00	424.25						
2	336.25	96.00	432.25	267.25	70.00	337.25	286.50	75.00	361.50
3	324.50	140.00	464.50	297.25	50.00	347.25			
4				312.50	105.00	417.50	422.75	90.00	512.75
5	233.50	32.00	265.50	427.75	120.00	547.75			
6	453.50	148.00	601.50	679.00	80.00	759.00	210.25	45.00	255.25
7			375.75	332.00	70.00	402.00	733.00	536.50	1,269.50
8			267.00				295.25	70.00	365.25
9	303.00	85.00	388.00				405.25	112.00	517.25
10	332.75	70.00	402.75	281.50	90.00	371.50	438.00	75.00	513.00
11				265.50	100.00	365.50	349.75	55.00	404.75
12	296.75	45.00	341.75	317.75	80.00	397.75			
13	390.25	80.00	470.25	344.25	144.00	488.25	365.50	55.00	420.50
14	494.25	120.00	614.25	421.25	90.00	511.25	294.25	88.00	382.25
15	750.75	0.00	750.75						
16	354.50	95.00	449.50	286.00	40.00	326.00	333.75	100.00	433.75
17	419.75	0.00	419.75	301.00	118.00	419.00	356.50	130.00	486.50
18							402.25	110.00	512.25
19	257.25	60.00	317.25	510.00	135.00	645.00			
20	346.25	45.00	391.25				345.75	95.00	440.75
21				349.50	95.00	444.50			
22	627.75	126.00	753.75				337.00	70.00	407.00
23	364.25	100.00	464.25				266.50	55.00	321.50
24	348.50	90.00	438.50	241.50	80.00	321.50	328.25	90.00	418.25
25				673.50	137.00	810.50	387.25	75.00	462.25
26	275.25	45.00	320.25	537.75	0.00	537.75			
27				327.00	80.00	407.00	292.75	45.00	337.75
28				354.00	130.00	484.00	336.75	65.00	401.75
29	278.00	90.00	368.00				213.75	40.00	253.75
30	346.25	80.00	426.25	291.75	70.00	361.75	323.75	70	393.75
31	374.00	70.00	444.00	461.75	60.00	521.75			
Total per z-tapes			10,591.25	8,279.75	1,944.00	10,223.75	7,724.75	2,146.50	9,871.25
Total per ST-1's			14,612.00			13,982.00			12,721.00
Total per TP Exs. 2 + 3			16,938.75			16,938.75			16,938.75

Day of Month	October-99			November-99			December-99		
	Bar	Package	Total	Bar	Package	Total	Bar	Package	Total
1	342.00	100.00	442.00	260.25	55.00	315.25	421.25	80.00	501.25
2	311.75	97.00	408.75	366.50	80.00	446.50	383.75	100.00	483.75
3				798.00	140.00	938.00	462.50	100.00	562.50
4	235.25	55.00	290.25	701.50	145.00	846.50	413.75	75.00	488.75
5	272.25	30.00	302.25	488.25	138.00	626.25			
6				488.25	100.00	588.25	248.00	60.00	308.00
7	762.75	0.00	762.75				249.50	70.00	319.50
8	370.25	124.00	494.25	281.75	80.00	361.75	427.00	110.00	537.00
9	435.00	135.00	570.00	375.75	80.00	455.75	290.25	86.00	376.25
10						632.00	445.75	100.00	545.75
11				496.50	118.00	614.50	412.50	130.00	542.50
12	257.75	50.00	307.75	587.00	176.00	763.00			
13	266.00	45.00	311.00	437.00	110.00	547.00	299.00	85.00	384.00
14	533.50	120.00	653.50				248.00	61.00	309.00
15	397.00	110.00	507.00	297.50	94.00	391.50	362.50	120.00	482.50
16	402.25	100.00	502.25	472.00	90.00	562.00			
17				313.25	75.00	388.25	317.00	106.00	423.00
18	281.00	92.00	373.00	619.00	175.00	794.00	314.75	130.00	444.75
19	333.25	110.00	443.25	547.00	125.00	672.00			
20	791.50	144.00	935.50	448.25	124.00	572.25			
21	718.25	110.00	828.25				213.00	55.00	268.00
22	408.75	120.00	528.75	352.00	85.00	437.00			
23	398.25	90.00	488.25	420.25	160.00	580.25			
24				1,528.75	275.00	1,803.75			
25	426.25	85.00	511.25						
26				529.25	138.00	667.25			
27				546.50	95.00	641.50	199.00	65.00	264.00
28	299.00	80.00	379.00				220.75	40.00	260.75
29	499.25	223.00	722.25						835.00
30	740.75	174.00	914.75	364.25	65.00	429.25	433.25	252.00	685.25
31									
Total per z-tapes	9,482.00	2,194.00	11,676.00			15,073.75			9,021.50
Total per ST-1's			14,596.00			18,018.00			13,042.00
Total per TP Exs. 2 + 3			16,938.75			16,938.75			16,938.75

Taxpayer Ex. 1 (the entries in bold italics represent amounts that were hand

written on pieces of paper; that is, amounts that were not from receipts produced by a cash register); Department Ex. 3 (entries under heading “Total per ST-1’s” taken from auditor’s schedule of data reported on ABC’s filed returns during the audit period); Taxpayer Exs. 2-3.

9. The z-tapes admitted as Taxpayer Exhibit 1 are consecutively date stamped except for the tapes made regarding the dates of 6/5/99 through 8/30/99, and those made for the dates of 11/15/99 through the end of the year. Taxpayer Ex. 1.
10. There are days for which no z-tapes exist. Taxpayer Ex. 1; Tr. pp. 114-15, 127-28 (Doe).
11. Most of the z-tapes have hand written numbers and words on them to indicate how many six-packs of domestic or imported beer, barrels of beer, and/or bottles of wine, were sold that day. Taxpayer Ex. 1.
12. There are pieces of paper included in Taxpayer Exhibit 1 which are not cash register tapes, but merely strips of paper on which separate amounts or one single amount is hand written. Taxpayer Ex. 1.
13. The z-tapes admitted as Taxpayer Exhibit 1 do not state the true amount of gross receipts ABC realized during 1999. Tr. pp. 112, 120-24, 129-32 (Doe).
14. Taxpayer Exhibit 2 reflects Doe’s estimate of ABC’s average 1999 monthly gross receipts that were subject to ROT from selling beer, either for immediate consumption at the bar, or as package goods. Taxpayer Ex. 2; Tr. pp. 82-85 (Doe). It also reflects Doe’s estimate of how much beer he either personally used or that ABC gave away to customers or others during an average month in 1999. Taxpayer Ex. 2; Tr. pp. 82-85 (Doe).

15. Taxpayer Exhibit 2 includes selling prices for domestic and premium beer, and the selling prices of packaged goods, available for sale during an average month in 1999. Taxpayer Ex. 2. The exhibit assumes that, but for “specials,” all premium brands of beer were sold at one price, and that the same was true for all domestic brands. *Id.* It does not include the selling price for the barrels of beer it sold during the audit period. Taxpayer Ex. 1 (e.g., z-tapes dated 5/25/99 and 5/26/99, showing sales of barrels of beer).
16. Taxpayer Exhibit 3 represents Doe’s estimate of ABC’s 1999 monthly average gross receipts from selling liquor for immediate consumption. Taxpayer Ex. 3; Tr. pp. 87-93 (Doe). It also represents Doe’s estimate of how much liquor he gave away to customers during an average month in 1999. Taxpayer Ex. 3; Tr. pp. 87-93 (Doe).
17. Taxpayer Exhibit 3 includes selling prices for liquor drinks available for sale during an average month in 1999. Taxpayer Ex. 3. The exhibit assumes that all liquor drinks were sold either in 3 oz. or in 5 oz. portions. It assumes that, but for specials, all 3 oz. drinks were sold for one price, and that all 5 oz. drinks were sold for one price. Taxpayer Ex. 3.
18. ABC did not offer into evidence books and records showing what its actual purchases were during the audit period, or during the single year regarding which Doe prepared ABC’s 1999 average monthly sales estimates.
19. Together, Taxpayer Exhibits 2 and 3 reflect that ABC realized, on average, approximately \$16,939.00 in gross receipts during each month in 1999. Taxpayer Exs. 2-3 (ABC’s estimates of what it referred to, respectively, as beer and liquor

sales during 1999).

20. On its monthly ROT returns filed during the audit period, ABC reported having received gross receipts of \$339,908 over the 27 month audit period, for an average of approximately \$12,589.00 per month during the audit period. Department Ex. 3 ($\$339,908/27 \approx \$12,589.00$).
21. Taxpayer Exhibits 2 and 3 do not account for ABC's use tax liability for the beer and liquor Doe estimated that he used or that ABC gave away during an average month in 1999. Taxpayer Exs. 2-3. Nor do the exhibits include ABC's actual cost price of the beer and liquor that it purchased for resale and then used and/or gave away, so that its use tax liability for those donations might be calculated. Taxpayer Exs. 2-3.
22. The Department assessed a fraud penalty as part of the NTL issued to taxpayer. Department Ex. 2.

Conclusions of Law:

Issue 1: Whether the Department Correctly Calculated ABC's Taxable Gross Receipts

The Department introduced a copy of the NTL it issued to ABC into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the Retailers' Occupation Tax Act ("ROTA"), that NTL constitutes the Department's prima facie case in this matter. 35 ILCS 120/4, 7. The Department's prima facie case is a rebuttable presumption. 35 ILCS 120/7; Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). The statutory presumption extends to all elements necessary for a determination that the tax and penalties assessed are due as determined by the

Department. *E.g.* Branson v. Department of Revenue, 68 Ill. 2d 247, 258, 659 N.E.2d 961, 966-67 (1995) (“nothing more [than the certified copy of the NPL] is needed to prove the Department’s claim for a tax penalty against the corporate officer or employee.”). That is to say, the presumption extends to the agency’s determination that ABC is engaged in retailing (Soho Club, Inc. v. Department of Revenue, 269 Ill. App. 3d 220, 232, 645 N.E.2d 1060, 1068 (1st Dist. 1995)), and that the transactions at issue here were subject to ROT. 35 ILCS 120/7.

A taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department’s assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Here, the Department determined that ABC did not accurately report the true amount of its taxable gross receipts on the monthly returns filed during the audit period. *See* Department Ex. 2. Thereafter, the auditor estimated taxable gross receipts by reviewing ABC’s purchases for resale during a given period, and projected an estimate of ABC’s sales for the audit period. *See id.* At hearing, ABC challenged the means by which the Department calculated and projected taxpayer’s gross receipts, and challenged the audit methods as not reflecting the way ABC actually conducted business.

ABC introduced certain documents into evidence at hearing. Taxpayer Exhibit 1 consists of a collection of z-tapes and other papers made by ABC regarding 1999.

Taxpayer Ex. 1; Tr. pp. 72- (Doe). Most of the z-tapes are consecutively date-stamped, except for the tapes made regarding the dates of 6/5/99 through 8/30/99, and those made for the dates of 11/15/99 through the end of the year. Taxpayer Ex. 1. Doe initially testified that Taxpayer Exhibit 1 included a z-tape for every day in 1999 (Tr. p. 73), but later conceded that that was not correct. Tr. p. 115. He also testified that he did not prepare a z-tape for Sundays, and totaled up Sunday's gross receipts on the z-tape prepared for the following Monday. Tr. p. 128 (Doe).¹ Most of the z-tapes have handwritten numbers and words on them indicating how many six-packs of domestic or imported beer, barrels of beer, and/or bottles of wine, were sold that day. Generally, those handwritten statements of the number of package goods sales (e.g., 22 dom[estic], 7 imp[ort]), are consistent with the z-tape's printed statement of the amount of the gross receipts rung up from such sales. There are, however, z-tapes that provide that ABC realized zero dollars from selling package goods, but which contain handwritten statements that package goods were sold. Taxpayer Ex. 1 (entries for 1/16/99, 4/30/99, 5/6/99, 7/15/99, 7/17/99, 8/26/99, and 10/7/99). There are pieces of paper included in Taxpayer Exhibit 1 which are not cash register tapes, but merely strips of paper on which separate amounts or one single amount is hand written. Taxpayer Exhibit 1 (entries for 5/29/99, 6/17/99, 6/21/99, 7/7/99, 7/8/99, 7/31/99, 8/7/99, 8/16/99, 8/27/99, 9/22/99, 10/15/99, 11/10/99 and 12/29/99).

After considering the specific contents of the z-tapes (*see supra* pp. 3-6, finding of fact number 8), and the other evidence of record, I conclude that those documents have

¹ Doe's practice of keeping two days on one z-tape is contrary to the ROT regulation requiring every retailer to keep, at a minimum, "[c]ash register tapes and other data which will provide a daily record of the gross amount of sales." 86 Ill. Admin. Code § 130.805(a)(1).

no probative effect on the issues presented by this matter. That is because Doe testified unequivocally at hearing that the z-tape totals do not reflect the true amount of ABC's gross sales for 1999. Tr. pp. 112, 120-24, 129-32 (Doe). Doe testified that ABC's z-tapes do not include the amount of cash that was taken out of ABC's cash register to pay vendors and others during a given day. Tr. pp. 112, 120-24, 129-32 (Doe). He further testified that those cash payments were made using the gross receipts ABC realized from sales to customers who kept a "tab" with it. Tr. pp. 98-99, 103 (Doe). Doe's explanation as to why ABC's z-tapes do not include all the gross receipts it received from selling property at retail leads to only one conclusion — ABC did not ring up all of its sales on its cash registers. Tr. pp. 98-99, 103 (Doe). During closing argument, taxpayer's counsel confirmed that fact. Tr. p. 141 (closing argument); *see also* Dora Township v. Indiana Ins. Co., 67 Ill. App. 3d 31, 32-33, 384 N.E.2d 595, 597 (4th Dist. 1979) (attorney's statement in open court constituted an admission by a party-opponent).

Based on Doe's own testimony, I conclude that the Department was justified in disregarding the amount of taxable gross receipts that ABC reported on its returns filed during the audit period. There can be no doubt here that ABC did not report the true amount of its gross receipts on the returns it filed during the audit period. Tr. pp. 98-99, 103 (Doe), 141.

To support its claim that the Department's audit was flawed, ABC introduced other documentary exhibits. Taxpayer Exhibits 2 and 3 constitute Doe's estimates of the gross receipts ABC received from selling beer and liquor, respectively, during an average month in 1999. Taxpayer Exs. 2-3; Tr. pp. 82, 87-88 (Doe). Those exhibits also detail

Doe's estimates of the number of beer and liquor drinks that ABC used — by giving them away to customers or to others — rather than sold at retail.

Taxpayer Ex. 2 is divided into three separate sections, each beginning with a statement of: the number of bottles of domestic beer (11,364) purchased in an average month in 1999; the number of bottles of premium beer (1,528) purchased in an average month in 1999; and the number of ounces of beer purchased in barrels (32,000) in an average month in 1999. Following those starting points, the exhibit accounts for how the purchased beer was either used or sold during an average month. The exhibit further provides different selling prices for the different types of beer sold.

In the section dealing with ABC's domestic beer purchases, Taxpayer Exhibit 2 begins with the number of bottles of domestic beer (11,364) that ABC claims that it purchased during an average month in 1999. The next entry subtracts 2,841 of those bottles (or 25% of the total beer purchased per month), from the 11,364 total. That entry is based on Doe's claim that ABC and "[e]very neighborhood bar gives away every fourth drink." Tr. p. 82 (Doe). The section then proceeds to account for: how many bottles of beer Doe drank in an average month (96); how many beers ABC gave away to different groups, i.e., softball teams (384), bowling teams (60), basketball teams (64), or gave away for block parties (48), donations (48), or to the persons who provided ABC with daily cleaning services (180), weekly cleaning services (48), and repair services (48). Taxpayer Ex. 2. The exhibit then estimates that ABC broke or spilled 114 bottles during an average month, leaving a total of 7,433 bottles of beer from the original 11,364 purchased during an average month.

Taxpayer Exhibit 2 then begins to count the number of bottles of beer that Doe claims that ABC sold in an average month in 1999. It begins with the statement that ABC sold an estimated 404 six-packs, as package goods, at a price of \$5.00 each. The exhibit then reflects that ABC sold some beer (120 bottles) for consumption on bus trips at 50¢ each, and that it sold some (1,632 bottles) at a “special” price of \$1.00 each. After again noting that ABC gave away some beer (96 bottles) to police and some (17 bottles) for appreciation nights, the exhibit finally indicates that ABC sold the remaining amount of beer (3,145 bottles) at a selling price of \$2.00 per bottle.

Taxpayer Exhibits 2 and 3 are not ABC’s regularly kept business records. *Compare* Tr. pp. 82-87 (Doe, being questioned about the entries on Taxpayer Ex. 2) *with* Illinois Supreme Court Rule § 236(a). Business records are considered reliable because of the regular, prompt, and systematic manner in which they are kept and the fact that they are relied upon in the operation of the business. In re A.B., S.B., A.B., J.B., and T.B. v. C.B., 308 Ill. App. 3d 227, 719 N.E.2d 348, 356 (2d Dist. 1999). A business record is “admissible as evidence of the act, transaction, occurrence, or event [described in the record].” Illinois Supreme Court Rule § 236(a).

Rather than being business records, Taxpayer Exhibits 2 and 3 were prepared in anticipation of litigation. Tr. p. 84 (Doe); In re N.W., 293 Ill. App. 3d 794, 688 N.E.2d 855 (1997) (a document is prepared in anticipation of litigation if it is prepared with an eye toward pending or anticipated litigation of any kind). Doe prepared Taxpayer Exhibits 2 and 3, or had them prepared, to offer into evidence his estimate of ABC’s sales and taxable gross receipts during a six month period in 1999, and to compare his estimate with the auditor’s determinations. Tr. pp. 82-85, 87-93 (Doe). Because they bear no

indicia of reliability, documents prepared in anticipation of litigation are not admissible into evidence unless they fall within another exception to the hearsay rule. In re A.B., S.B., A.B., J.B., and T.B., 308 Ill. App. 3d at 236, 719 N.E.2d at 355. Taxpayer Exhibits 2 and 3, therefore, are hearsay, but hearsay admitted without objection.

When hearsay evidence is admitted without an objection, it is to be considered and given its natural probative effect. Jackson v. Department of Labor, 105 Ill. 2d 501, 508, 475 N.E.2d 879, 883 (1985). Whether proffered evidence has a tendency to prove a fact in controversy or render a matter in issue more or less probable must be tested in light of logic, experience, and accepted assumptions as to human behavior. Dayan v. McDonald's Corp., 125 Ill. App. 3d 972, 982, 466 N.E.2d 958, 966 (1st Dist. 1984) (citing Marut v. Costello, 34 Ill. 2d 125, 127, 214 N.E.2d 768 (1966)). I cannot conclude that Taxpayer Exhibits 2 and 3 reflect ABC's actual taxable gross receipts during the audit period.

I begin with Taxpayer Exhibit 2, which purports to reflect ABC's actual taxable gross receipts from selling beer during 1999. Within that exhibit, Doe takes 25% off the top of ABC's claimed monthly average domestic beer purchases. Even assuming that the 25% giveaway rate of domestic beer sold were accurate — and I do not find Doe competent to testify that “Every neighborhood bar gives away every fourth drink” (Tr. p. 82 (Doe)) — Taxpayer Exhibit 2 wrongly applies that rate. Taking 25% off the top of the 11,364 bottles of beer that Doe claimed to have purchased during an average month in 1999 makes sense only if Doe sold the remaining 75% of that total to customers for consumption at the bar. Doe never testified that ABC gave away every fourth drink *it*

purchased for resale. Nor does the exhibit reflect that ABC gave away every fourth six pack of beer sold as package goods. Taxpayer Ex. 2.

Rather, Doe's testimony about free drink giveaways can only be understood to mean that ABC gave away every fourth drink *a customer ordered from ABC*. Tr. p. 82 (Doe). In that way, Taxpayer Exhibit 2 is fundamentally flawed because it takes 25% off the top of ABC's claimed average monthly purchases for resale, before taking into account the quantity of beer it claims to have actually sold at retail. The 25% figure should not have been used as a subtraction from ABC's purchases. Rather, and only to the extent that ABC's claimed giveaways were actually shown to have occurred, they should have been counted as a deduction of the total number of drinks that were sold for consumption at the bar, at the regular selling price of \$2 each.²

Moreover, the exhibits' use of an assumed actual 25% giveaway rate is neither logically sound nor credible. For Doe's testimony regarding ABC's purported 25% giveaway rate to be literally true, it would mean that every single customer ordered at least three or four drinks each time he went into ABC. If a customer orders only one or two drinks, he will not receive a free drink — it's the third or fourth ordered drink that triggers the giveaway.³ But what is the likelihood that each and every customer ordered at least three or four drinks — and consistent multiples thereof, if they stayed and ordered

² As a practical matter, that means that the 25% calculation should be eliminated from a function of the total bottles purchased (2,841) and dropped down and added to the number of bottles of beer (3,145) Doe indicates were sold at the regular retail price of \$2 each. Taxpayer Ex. 2. Twenty-five percent of that total, 5,986, is approximately 1,496. Assuming, again, that the 25% figure were accurate — and I do not accept that assumption — the exhibit should have stated that 4,490 bottles of beer were sold for \$2 each, for gross receipts of \$8,980.

³ I accept the possibility that the free, fourth drink might be given away once the third drink is ordered, but that is nowhere made clear by Doe's testimony. My point here is the unlikelihood that a consistent 25% giveaway rate actually occurred.

more⁴ — every time they entered ABC? Doe, in Taxpayer Exhibit 2, deemed the likelihood 100%. Because I find that proposition inconsistent with human experience, I will not take Doe's mere word that that exact scenario occurred throughout 1999.

And while Taxpayer Exhibit 3 at least limits the 25% giveaway rule to the drinks Doe alleges were actually sold for consumption at the bar, it also assumes Doe's ability to recall exactly how many 2 oz., 3 oz., and 5 oz. drinks ABC sold during an average month in 1999. Taxpayer Ex. 3; Tr. pp. 92-93 (Doe). Specifically, Doe was asked the following questions and gave the following answers regarding that exhibit:

Q: Now these calculations that you made during a six-month period, what is it — what's the basis that you use to start from to reach these — to start off with these calculations?

A: How did I start this off?

Q: Right.

A: First, I went back and added all the receipts up from January through June. All the bottles were calculated times 33 ounces.

Q: Why it is —

A: That's a liter. They're liters. 33 ounces were the total. I made my deductions from there.

Q: All these calculations are based upon the actual size of the drink?

A: Yes.

Q: Actual giveaways to customers?

A: Yes.

Q: And the actual multiple liquor drinks?

A: Right.

⁴ The third or fourth drink scenario must repeat itself consistently for Doe's professed 25% giveaway rate to be true and accurate. Consider the following example. A customer comes in, orders three drinks, and receives the free drink as his fourth. He orders two more drinks and then leaves. Under those circumstances, the customer receives 1 free drink out of six actually served, equaling a giveaway rate of roughly 17%. Consider another example. Five customers come in, order two drinks each, and then leave. Under that scenario, none of the ten drinks ordered is free. Combine the two examples, and the giveaway rate is 1 out of 16, or 6.25%. Doe's proposed 25% giveaway rate requires near perfect consistency from its customers, which, itself, is inconsistent with ordinary, random human behavior.

Tr. pp. 92-93 (Doe).

These particular questions and answers, as well as others (Tr. p. 84 (Doe)), reflect the overriding reason why Taxpayer Exhibits 2 and 3 are not probative on the question of what ABC's actual taxable gross receipts were during the audit period. The underlying basis for most of the figures on Taxpayer Exhibits 2 and 3 is Doe's mere say so. Nothing within this record makes me believe that Doe had the ability to accurately recall, *inter alia*, the *actual* number of each different type and size of drink that ABC served or gave away during an entire six-month period in 1999. Doe was estimating in Taxpayer Exhibits 2 and 3, just like the Department auditor was estimating when he performed his audit, using the best available information. Both Doe and the auditor had to estimate, moreover, because ABC had no books and records showing its actual daily gross sales. 86 Ill. Admin. Code § 130.805(a)(1). And while Doe testified that he prepared the exhibits using "[his] own records of past and present" (Tr. p. 84 (Doe)), it was ABC's obligation to produce such records at hearing to support its claim that the Department's determination were wrong. Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7.

Pursuant to statute, the Department's determinations are given presumptive correctness. 35 ILCS 120/4, 7. A taxpayer rebuts the statutory presumption of correctness when it presents documentary evidence closely identified with its regularly kept books and records to show that the Department's determinations were incorrect. A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. ABC's books and records might have rebutted the auditor's estimate of ABC's total gross receipts, but — as a matter of law — Doe's written guesses cannot. Fillichio, 15 Ill. 2d at 336, 155 N.E.2d at 8 ("taxpayer's evidence must be credible evidence"). I conclude that Doe's

estimates, as reflected on Taxpayer Exhibit 2, 3 and 5, have no probative effect on the question of whether the Department properly calculated ABC's taxable gross receipts during the audit period. They are further insufficient to demonstrate what ABC's actual taxable gross receipts were.

Issue 2: Was the Imposition of a Fraud Penalty Appropriate

The Department assessed a 50% fraud penalty against ABC. Department Ex. 1, p. 2. Taxpayer argues that that was improper, and that the facts and circumstances of this matter do not warrant a fraud penalty. Tr. p. 141.

Section 3-6 of the Uniform Penalty and Interest Act provides, in part:

Penalty for fraud.

(a) If any return or amended return is filed with intent to defraud, in addition to any penalty imposed under Section 3-3 of this Act, a penalty shall be imposed in an amount equal to 50% of any resulting deficiency.

* * * *

35 ILCS 735/3-6 (1994). The standard for determining whether a fraud penalty is appropriate is clear and convincing evidence. Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4th Dist. 1983). Clear and convincing evidence of an intent to defraud can be circumstantial in nature. *E.g.*, Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3d Dist. 1983). Most frequently, the circumstances evincing an intent to fraud are revealed by an examination of the extent to which a taxpayer underreported the true amount of its gross receipts, and an examination of whether the failure to properly report was intentional or otherwise. *See id.*

In this case, Doe and his attorney conceded that ABC underreported taxable gross receipts by between approximately \$4,800.00 to \$6,000.00 for each month in the audit

period. Tr. pp. 112 (Doe), 141 (counsel for taxpayer). That occurred, in large part, because Doe or someone else at ABC did not ring up all of the sales made in the ordinary course of business. Tr. p. 141. The \$4,800.00 to \$6,000.00 in monthly underreported gross receipts, according to Doe, consisted largely of his collections of tabs that customers paid after he extended credit to them for drinks previously sold. Tr. pp. 98-102 (Doe). Doe explained ABC's failure to report all of its sales as a "miscommunication with the accountant." Tr. p. 102 (Doe).

Doe's proffered explanation of ABC's routine and consistent failure to record all of its retail sales is not credible. He did not merely communicate unclearly or inadequately with his accountant. *See* The American Heritage Dictionary of the English Language (4th ed. 2000) (Houghton Mifflin Co.) (definition of "miscommunication") (online version, www.dictionary.com). The evidence shows that Doe knew that he was making sales to customers who kept a tab. Tr. pp. 98-99 (Doe). He knew he was collecting moneys from such customers. Tr. pp. 119-20 (Doe). He also knew that he was not recording those gross receipts by actually ringing them up on ABC's cash register, either when the drink was served or when the tab was paid. Tr. pp. 98-99, 119-20 (Doe). Whether Doe's explanation as to why the z-tapes or the filed returns did not include all of ABC's sales is true or not, ABC treated sales on credit as though they were not sales at all. That consistent and self-interested action was not the result of any communication, or miscommunication, between Doe and his accountant. Tr. p. 120 (Q: Did it [the money ABC took in from tabs] show up in these "Z" tapes? A: No, it did not. That's what the whole mistake was on my part.")).

Moreover, the amount of ABC's admitted underreporting constitutes a significant proportion of ABC's originally reported gross receipts. For the audit period, ABC reported, on average, \$12,589.00 in total gross receipts each month. Department Ex. 3. At hearing, Doe admitted to not reporting between \$4,800 to \$6,000 each month. Tr. pp. 120, 129-30 (Doe). That means that the returns ABC filed during the audit period failed to report about 38% to 48% of its total sales. And even if one chose to believe Doe's estimates of ABC's sales during the audit period, those exhibits show that, for each month in the audit period, ABC's filed returns did not report approximately \$4,350 of what Doe now admits were taxable gross receipts. Taxpayer Exs. 2-3; Department Ex. 3 ($16,939 - 12,589 = 4,350$). That is an underreporting rate of about 35%. Taxpayer Exs. 2-3; Department Ex. 3 ($4,350/12,589 \approx .345539$). This, again, is the amount of ROT underreporting that Doe and ABC admit. When a person consistently and knowingly reports only two of each three dollars in sales — in effect, “two for you, one for me” — that deliberate action evinces an intent to defraud.

Conclusion:

ABC has not rebutted the prima facie correctness of the Department's calculation of ABC's taxable gross receipts during the audit period. I also conclude that the evidence showing ABC's consistent, admitted and substantial underreporting of its true taxable gross receipts throughout the audit period constitutes clear and convincing evidence that ABC filed its returns with an intent to defraud. I recommend, therefore, that the Director finalize the Department's NTL as issued, with interest to accrue pursuant to statute.

Date: 7/28/2003

John E. White
Administrative Law Judge